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The Public Utility in Bankruptcy: A Reality

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OVERVIEW
The Public Utility in Bankruptcy: A Reality

by

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During the last several years, the public utility industry and the bankruptcy bar have focused a great deal of attention on the suitability of bankruptcy as a source of relief for the financially distressed public utility. The initial response to the idea that a public utility might resort to such relief seemed improbable, due to the fact that there had not been a bankruptcy of a privately-owned public utility in this country since the Depression of the 1930's. Much of this has been explained by virtue of the fact that the regulatory structure of our public utility industry could protect a utility from financial crisis through an adjustment in rates. In spite of these views, the public utility in bankruptcy became a reality in January of 1988, when the Public Service Company of New Hampshire ("Public Service Co."), an electric utility, filed a Chapter 11 petition for reorganization under the Bankruptcy Code.

It is this improbable event that will be the focus of this "Overview" essay. The bankruptcy of Public Service Co. merits continued and close focus because it provides an opportunity to study the actual progression of a public utility in the bankruptcy process. For years, the discussion concerning the fate of the public utility in our bankruptcy system has naturally been academic and speculative due to lack of precedence in such matters. This course of action taken by Public Service Co. permits the public utility industry and bankruptcy bar to focus their discussion of the bankrupt public utility by being able to identify the kind of crisis that makes relief at bankruptcy the only viable choice. We can also explore the concerns and doubts previously expressed about the feasibility of bankruptcy as a source of relief to the financially- troubled public utility from a new and more pragmatic perspective. This exploration can begin by addressing the following questions:

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1. How have previously expressed concerns and doubts about the appropriateness of bankruptcy as a forum of relief for public utilities actually materialized in the case of Public Service Co.?

2. How has the bankruptcy system responded to these issues?

3. Are the problems of the public utility reorganization the result of flawed or inadequate bankruptcy laws or do they transcend the bankruptcy system?

The Bankruptcy Crisis of Public Service Co.[1]

At the time that Public Service Co.[2] filed its Chapter 11 petition, its electrical generating and distribution systems were regarded as being financially sound. However, it had encountered difficulty in obtaining the necessary state and federal regulatory and licensing approval to bring its recently completed nuclear plant in Seabrook, New Hampshire, on-line. The problem in obtaining this necessary approval was found in an unacceptable plan that it had submitted delineating the safe evacuation of areas surrounding the plant in the event of a nuclear accident. Because Public Service Co. has not been able to bring the nuclear plant into full operation, it has been unable to recoup its $2 billion investment in the plant, pursuant to a New Hampshire statute prohibiting utilities from including construction works in progress, or nonoperational projects, in their rate base for customer service charges ("anti-CWIP statute").[3]

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1. This background summary of the circumstances leading to the filing of the Chapter 11 reorganization by Public Service Co. is based on the description of facts in In re Public Service Co. of New Hampshire, 88 B.R. 521 (Bankr.D.N.H. 1988) (hereinafter Public Service Co. I).

2. Public Service Co. of New Hampshire is the largest electric utility in New Hampshire, serving a vast majority of the State's electricity consumers. It is a privately-owned utility, that is, it is owned by private investors and not a municipality or governmental agency. As with most utilities, it is heavily regulated by both federal and state agencies.

3. Much of the opposition to the operation of the plant came from consumer and environmental groups, as well as the Governor of Massachusetts. Public Service Co. I, 88 B.R. at 523 n 3.

The effects of this statutory prohibition have been extremely costly for Public Service Co. The inability of Public Service Co. to come on-line resulted in a drain on its cash flow; it adversely affected Public Service Co.'s ability to pay its secured debt obligations; and it reduced the resources required by Public Service Co. to maintain normal operation of its overall system. Because of the increased delay in obtaining this regulatory approval and the dim prospects of winning such approval due to significant outside opposition to the plant, Public Service Co.'s expectations of being able to include the cost of the nuclear plant in its revenue base under the present state regulatory structure seemed futile, prompting it to seek relief at bankruptcy.[4]

Public Utilities in Bankruptcy: Will It Work?

As noted above, the event of a public utility bankruptcy has been the focus of much discourse in recent years. In assessing whether our bankruptcy system would be able to accommodate the public utility, several commentators have identified issues that might surface in the public utility bankruptcy that would not be easily addressed under the Bankruptcy Code due to insufficiencies and uncertainties in relevant Code provisions.[5] The issue that appears to be most unique to the public utility in bankruptcy is how to provide adequate representation in the bankruptcy proceedings to the many groups that would be affected by the reorganization, but who do not fall within the categories of typically interested parties such as creditors, investors, and shareholders. In particular, there is a need to consider the interest and role of the state utility regulator and the public utility ratepayer in the reorganization proceedings.[6]

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4. Public Service Co. also waged a challenge against New Hampshire's anti-CWIP statute in the courts, asserting that it was an unconstitutional violation of due process under the Fifth and Fourteenth Amendments of the Constitution. On January 23, 1989, the Supreme Court upheld the New Hampshire Supreme Court ruling that the statute was constitutional. Public Service Co. of New Hampshire v. New Hampshire, 539A.2d 263 (N.H. 1988), appeal dismissed, 57U.S.L.W. 3481 (U.S. Jan. 24, 1989)(No. 87-1613).

5. See: Eisenberg, *Bankruptcy in the Administrative State*, 50 Law & Contemp. Problems 3, 9-11 (1987) and Flaschen & Reilly, *Bankruptcy Analysis of a Financially-Troubled Electric Utility*, 22 Hous. L. Rev. 965, 968 (1985). Both articles can be found at X **Public Utilities Law Anthology** 549 (1987) and VIII **Public Utilities Law Anthology** 3 (1984-1985), respectively.

6. Eisenberg, supra note 5 at 24-26 and Flaschen & Reilly, supra note 5 at 971-972.

Section 1129(a)(6) of the Code provides that a bankruptcy court "shall confirm a plan only if . . . the governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval."[7] Section 362(b) of the Code permits governmental units to commence or to continue any action to enforce its regulatory power, over a debtor.[8] This provision is an exception to the general prohibition against the commencement or continuation of an adversary action against a debtor who has sought relief under the Code; such actions are generally stayed pursuant to section 362(a)(1) of the Code.[9] It has been suggested that these few provisions offer "scant guidance" for the bankruptcy court in determining the extent of the participation of the state regulator in the reorganization process, and leaves the court with a great deal of flexibility in addressing the question.[10]

Section 1129(a)(6) has been interpreted as granting the bankruptcy court "*discretion* whether to condition [reorganization] plan approval upon subsequent regulatory approval or to require that regulatory approval be obtained prior to bankruptcy court approval."[11] One commentator has stated that an argument could be made that "the Bankruptcy Code's failure to require [the regulator's] approval over rate changes *before* confirmation indicates a legislative intent to allow the bankruptcy court to control rate increases before a plan is confirmed."[12]

Perhaps the question of the legislative intent of Congress regarding the extent of the regulator's authority during the bankruptcy process can be found in the broad language of section 105(a) of the Code, which authorizes the court to "issue any order, process, or judgment necessary or appropriate to carry out the provisions of this title."[13] Such language further supports the proposition that the bankruptcy court would have "regulatory dominance" over the state regulator under the Code.[14]

7. 11 U.S.C. Section 1129(a)(6).

8. 11 U.S.C. Section 362 (b)(4).

9. 11 U.S.C. Section 362 (a).

10. Eisenberg, supra note 5 at 12-13.

11. Id. (emphasis added).

12. Flaschen & Reilly, supra note 5 at 976.

13. 11 U.S.C. Section 105(a).

14. Eisenberg, supra note 5 at 13.

Another issue regarding adequate representation under the bankruptcy process focuses on the public utility ratepayer. Although public utility customers do not have the typical creditor or investor interests that are usually represented at bankruptcy, they will be directly affected by the reorganization through possible rate increases.[15] If they are given representation in the proceedings there is concern that their interest will conflict with those of the public utility creditor, investor, and shareholder. An issue associated with "enhanced representation" involves the cost that this would have on the reorganization.[16] With additional parties participating in the process, it would cause delays in the development of a plan and its approval. The cost of enhanced representation would be paid by the estate and consequently result in a loss to creditors, investors, and shareholders.

Other issues have been identified as potential areas of concern in the public utility bankruptcy. However, these issues would not be unique to a public utility in bankruptcy, and could be expected to arise in any Chapter 11 reorganization of a major business entity with a complex financial structure. Some of these issues include: allegations of mismanagement and requests for the appointment of a trustee; requests for adequate protection of secured claims by the public utility's creditors; difficulties in obtaining postpetition financing by a bankrupt public utility; and difficulties in valuation of the public utility.[17]

Public Service Co. of New Hampshire at Bankruptcy

Since the filing of the Chapter 11 petition by Public Service Co. in January of 1988, several motions for relief under the Code have been heard by the Bankruptcy Court for the District of New Hampshire. One of these cases addresses issues regarding "enhanced representation." Another case addresses the issue of delays in the public utility reorganization, and why a reorganization of a public utility is likely to demand and warrant more time than may normally be required during the bankruptcy process.

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15. Id. at 25-26.

16. Id. at 31-34.

17. See: Flaschen & Reilly, supra note 5 at 981-1005. Also see: In re Public Service Co. of New Hampshire, 88 B.R. 558 (Bankr.D.N.H. 1988). This case involved a request for adequate protection in the form of interest payments by Third Mortgage Bondholders of Public Service Co.

One of the first motions heard during the Public Service Co. reorganization was a request for an extention of the period allowed under the Code for the debtor to exercise an exclusive right to file its plan of reorganization.[18] Section 1121(b) of the Code provides that the debtor has the exclusive right to file a plan of reorganization during a 120-day period after an order of relief.[19] This right is very important because it protects the debtor's attempts to devise and file a plan of reorganization without having to compete with alternate plans proposed by any creditors, investors, or other parties in interest. The time allowed to the debtor for exclusive filing is limited to 120 days after the date of the order of relief.[20] Once this period expires and the debtor either fails to file a plan, or its filed plan has not been accepted within 180 days after the date of the order of relief, parties of interest may be entitled to submit their own plans. This period may be extended on a showing "for cause" by the debtor.[21]

The Public Service Co. based its request for an eight-month extention of the exclusivity period on the basis of the complexity and size of the case.[22] In delineating the standard for review on this issue, the court noted that the complexity and size of a case alone is not a sufficient basis for permitting an extension of this period, and that there must also be evidence that there is some probability of success on the part of the debtor in formulating a plan of reorganization.[23] The debtor needs to demonstrate the "likelihood of an imminent consensual plan"; the court must also be certain that "no alternate substantial plan [is] being held off by the debtor's exclusivity"; and that this extension would not result in the debtor holding the "creditors and other parties in interest 'hostage.'"[24]

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18. Public Service Co. I, 88 B.R. 521.

19. 11 U.S.C. Secion 1121(b).

20. Because this was a voluntary bankruptcy action by Public Service Co., the "order of relief" occurred at the time that Public Service Co. filed its Chapter 11 petition, pursuant to section 301 of the Code. 11 U.S.C. Section 301.

21. 11 U.S.C. Section 1121(d).

22. Public Service Co. I, 88 B.R. at 527.

23. Id. at 537.

24. Id.

Although the court stated that complexity and size cannot be the sole reasons to base an extension of exclusivity, it took notice of these factors as they related to the Public Service Co. The court stated that in order to understand the issue of complexity in the reorganization of Public Service Co., one had to appreciate the regulatory structure under which it operated, which is typical of any public utility. It noted that the rate structure of Public Service Co. is regulated by a state public utility commission. This authority determines the terms and conditions under which Public Service Co. provides service to its customers; regulates Public Service Co.'s issuance and sale of stocks, bonds, notes, other indebtedness and the mortgaging of utility assets; approves any transfer or lease of utility property, or contracts with others to operate its property; and approves the purposes for which any proceeds earned by Public Service Co. are to be used.[25]

The court also noted, however, that under the Bankruptcy Code, its jurisdiction covers many of the same areas of regulatory authority of the state regulator. Under the Code, the bankruptcy court has jurisdiction over all property of the debtor and the estate; sales or transfers of property of the estate; gains earned on any sale in the reorganization; contracts for purchase or sale of power or fuel; and acquisitions of credit and issuances of debt by the debtor.[26] The court recognized that the role of the state utility commission is so expansive that it would not be unreasonable to expect it to assert that any reorganization plan proposing "a sale of assets, a corporate restructuring, an issuance of new securities, or even the rejection of executory contracts for the purchase or sale of fuel or power presents a conflict between the jurisdiction of the [bankruptcy court] and the [state utility regulator] and that concurrent approval is required."[27] The court held that because these issues are "novel and complex, have no precedent, [they] must be fully analyzed from a financial, legal, practical and strategic basis before meaningful negotiations toward a consensual plan can proceed."[28] The court concluded that additional time was needed particularly in light of the jurisdictional issues involved, and in order for the debtor to have the time to negotiate with the state regulator for a consensual resolution of these issues.

25. Id. at 527-529.

26. Id. at 529-530.

27. Id. at 530.

28. Id.

In spite of objections to an eight-month extension by various creditors of Public Service Co., the court granted the extension, which expired on December 27, 1988. The court held that while all of the uncertainties in a case like this might not be completely resolved within this time period, it believed that some would be resolved, others would come into focus with "a meaningful range of possible results," and the plan would "foster a better understanding of the facts involved."[29]

In conclusion, the court also recognized that the cost of this delay would be borne by administrative expenses and it would result in some damage to the intrinsic value of the inoperative nuclear plant. When it considered the complexity and novelty of the case, and the fact that the debtor had already worked on four possible plans for reorganization with expert advisors since the filing, the court was convinced that the debtor had satisfied the requirements for the extension.

The second motion heard by the court involved a request by several interest groups for representation status in the bankruptcy proceeding as full parties in interest and/or for general intervention rights.[30] This case directly addressed the issue of representation, and the extent of such representation, by parties with an interest in the reorganization who do not satisfy the traditional creditor or investor status under the Code. The parties in this case included the State of New Hampshire, the State of Connecticut, the Connecticut Department of Public Utility Control, the Office of Consumer Advocate of the State of New Hampshire, the Business and Industry Association of New Hampshire, and the Citizens Within the 10 Mile Radius, Inc., The Seacoast Anti-Pollution League, and the Campaign for Ratepayer's Rights. The Public Service Co. and several creditors' committees argued that these groups should not be granted full party in interest status or general intervener rights in the proceedings because they did not qualify as creditors; their interest might be contrary to creditors and shareholders; they are represented by regulatory agencies that are charged with the public interest; and consumer interests and rights are specifically represented in the Code through the attorney general of a state.[31] They argued that the rights of these groups

29. Id. at 537.

30. In re Public Service Co. of New Hampshire, 88 B.R. 546 (Bankr.D.N.H. 1988) (hereinafter Public Service Co. II).

31. Pursuant to Bankruptcy Rule 2018(b), a state's attorney general may be granted intervenor status to represent the interest of consumers in a bankruptcy proceeding. B.Rule 2018(b).

to be represented should be considered on an "issue-by-issue" basis as the proceedings developed.[32]

Under section 1109(b) of the Code, a party in interest includes "the debtor, the trustee, a creditor's committee, an equity security holders' committee, a creditor, an equity security holder, or any indentured trustee"; they enjoy the right to raise issues in the proceedings and to appear and be heard on issues in the case.[33] Bankruptcy Rule 2018(a) provides for permissive intervention, which allows the court to permit any "interested entity to intervene generally or with respect to any specified matter."[34] Permissive intervention is granted on a showing of cause. Under this rule, the court will consider whether there is an "economic or similar interest" involved, or if the entity requesting intervention is "concerned with possible conflicts between Chapter 11 policies and state regulatory policies."[35] The court must also consider whether the intervention or party in interest status will cause undue delays and become overburdening to the reorganization process; will it interfere with a speedy reorganization; will new issues be raised as a result of the inclusion; will it prejudice the original parties; and are the entity's interests already being adequately represented.[36] The court also noted that such requests are usually made by such entities for representation or voice as to "specific" matters that arise in the proceedings, and not in the "abstract" as a general question of status on all matters that might be raised in the case.[37]

Due to the complexity of the case and the general context to which these issues were being raised, the court deferred rendering a decision on these issues of representation and intervention until they arise in relation to specific matters. There were three exceptions to this deferral, one of which involved the State of New Hampshire. Because of its statutory rights under section 1129(a)(6) of the Code, requiring its regulatory approval on any rate change proposed in the plan and its vast regulatory authority over Public Service Co. under state law, it was granted full party in interest status and a general

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32. Public Service Co. II, 88 B.R. at 549.

33. 11 U.S.C. Section 1109(b).

34. B.Rule 2018(a).

35. Public Service Co. II, 88 B.R. at 551, citing 8 Collier on Bankruptcy, para. 2018.03 [3] at 2018-7 (15th ed. 1988).

36. Id. at 551.

37. Id. at 554.

right to intervention. The court also recognized the expertise of interest groups such as the Office of Consumer Advocate of the State of New Hampshire and the Business and Industry Association of New Hampshire. These two interest groups were granted a limited right of intervention on issues involving rates and tariffs that would impact their constituencies. The court believed that such an expansion in representation would expedite the proceedings rather than be a burden to the reorganization process.[38]

The Saga Continues

Pursuant to the eight-month extension that the bankruptcy court granted Public Service Co., a plan of reorganization was submitted on December 27, 1988. Several courses of action were proposed under the plan.[39] The most controversial proposal involved a restructuring of the utility that would bring it under the regulatory jurisdiction of the Federal Energy Regulatory Commission. Under this plan a utility holding company would be created and two subsidiaries would be formed. One subsidiary would generate and transmit electricity for wholesale. Because it would be selling electricity at wholesale, its rates would be subject to approval by the Federal Energy Regulatory Commission. The second subsidiary would purchase power from the sister subsidiary and distribute that electricity to utility consumers. Although its rates would be set by the New Hampshire Public Utilities Commission, they would be directly affected by the federally approved wholesale rates.

Under this federally dominated regulatory structure, Public Service Co. would be able to avoid the anti-CWIP provisions of New Hampshire and to include the cost of the construction of the Seabrook plant in its rate base. This would permit Public Service Co. to increase its rates significantly to recoup these investments regardless of the operational status of the plant. The plan also provides that Public Service Co. will continue to pursue bids from several companies that have expressed an interest in buying its assets. Although these are the proposals included in the plan, Public Service Co. expressed a preference to resume negotiations with the State of New Hampshire on the rate question, rather than having to exercise either of these options.[40]

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38. Id. at 557.

39. *The Boston Globe*, Dec. 28, 1988, Economy p. 57.

40. Id.

The State of New Hampshire's reaction to the plan was not favorable, particularly in light of the proposal to restructure the utility in order to come within the federal regulatory control. The State was offended by this attempt to circumvent its regulatory authority, and attempted to prevent this through several legislative actions and threatened to pursue it in the appellate process if necessary.[41] On January 13, 1989, the State discontinued its negotiations with Public Service Co. as a result of a deadlock in rate increase negotiations.[42]

Recent reports indicate that on February 1, 1989, a motion was filed in the bankruptcy court for a determination as to whether bankruptcy law pre-empts the state regulatory authority and whether the state may set rates during the bankruptcy proceedings.[43] The bankruptcy court will also consider whether alternate plans of reorganization may be submitted, since the debtor's period of exclusivity expired on February 27, 1989. The Public Service Co. has requested an additional extension of the period of exclusivity to negotiate the plan.[44] The State and one of its potential buyers, Northeast Utilities, are opposed to any extension and would like the proceedings to be open to the submission of alternate plans, which they propose should include any submission of bids to purchase Public Service Co.'s assets for consideration and approval by Public Service Co. creditors and shareholders.[45]

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41. Senators Gordon Humphrey and Warren Rudman of New Hampshire introduced a bill in the Senate on January 25, 1989, to amend the Bankruptcy Code to require prior approval by state electric utility regulators before a bankruptcy court may approve any reorganization plan for a bankrupt electric utility. The purpose of this bill is to prevent utilities from trying to avoid state regulators through bankruptcy. S.46, 101st Cong. 1st Sess., 135 CONG. REC. S339-340 (daily ed. Jan. 25, 1989).

Similarly, at the state level, state legislators have proposed legislation that would create a state public power authority for the purpose of enabling the state to takeover a public utility. *N.Y. Times*, Dec. 29, 1988, Section D (Financial Desk) p. 7.

42. *The Boston Globe*, Feb. 10, 1989, Economy p. 21.

43. *N.Y. Times*, Feb. 28, 1989, Section D (Financial Desk) p. 1.

44. *The Boston Globe*, Feb. 22, 1989, Economy p. 61.

45. Id.

The reorganization efforts of Public Service Co. have been most contentious, encompassing a power struggle between the State of New Hampshire to retain its regulatory authority over the utility and the efforts of Public Service Co. to free itself from the regulatory limitations of such authority. The political undertones of this reorganization have been overwhelming and most problematic in the negotiation process. In view of this struggle, it does not seem that the problems of the reorganization are due to any inadequacies of the bankruptcy system.

It was the objective of the bankrupcty court to expedite the resolution of this case. In Public Service Co. II, the State of New Hampshire was granted full party in interest status and general intervener status in the reorganization proceedings:

> [R]ather than burdening the reorganization process of a regulated electric utility, the granting of such status and rights to the State of New Hampshire should expedite the progress of this reorganization proceeding. The intended result of this ruling is to grant the State of New Hampshire an unquestioned place at the bargaining table in the process of plan formulation. Taking that place at the bargaining table will necessarily force the State of New Hampshire to come to grips with various legal and factual issues which could otherwise significantly delay the reorganization process.[46]

It would be wrong to condemn the bankruptcy system as being an improper or inadequate forum for the financially distressed public utility because the bankruptcy court's initial hopes for enhanced representation have failed to produce a speedy resolution of the matter. The problems of this reorganization must rest with politics and power struggles between the State of New Hampshire and Public Service Co. However, knowing the vast equitable and discretionary powers that our federal courts have under the Bankruptcy Code, it would not be imprudent to predict that this deadlock in the Public Service Co. reorganization will be resolved under our bankruptcy laws.[47]

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46. Public Service Co. II, 88 B.R. at 557.

47. This "Overview" of the status of the Public Service Co. reorganization was written in March 1989, and is based on information available at that time.